Supreme Court, U.S.
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No. 01-656

IN THE

Supreme Court of the United States

A.D. BEDELL WHOLESALE COMPANY, INC., TRIANGLE CANDY & TOBACCO CO., on behalf of themselves and all others similarly situated,

Petitioners,

v.

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, INC., BROWN AND WILLIAMSON TOBACCO CORP.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICI CURIAE FREEDOM HOLDINGS, INC. d/b/a NORTH AMERICAN TRADING COMPANY, INTERNATIONAL TOBACCO PARTNERS, LLC, PHILIPS & KING INTERNATIONAL, INC. and TOBACCO HOLDINGS, INC. IN SUPPORT OF PETITIONERS

IRVING BIZAR
BALLON STOLL BADER & NADLER, P.C.
Attorneys for Amici Curiae
1450 Broadway
14th Floor
New York, NY 10018-2268
(212) 575-7900

170555

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

TABLE OF CONTENTS

	Page
Table of Cited Authorities	ii
Interest of Amici	1
Statement	3
Conclusion	13

TABLE OF CITED AUTHORITIES

Page

Cases:

Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 5, 12

California Retail Liquor Dealers Assn v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) 12

Dennis v. Higging, 498 U.S. 439 (1991) 7

Exxon Corp. v. Eagerton, 462 U.S. 176 (1983) 5, 12

Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) 5, 12

Metropolitan Life Insurance Co. v. Ward, 470 U.S. 869 (1985) 5, 12

North American Trading Company, et al. v. NAAG, et al., Civ. Act. No. 01-1600 (PLF), was filed on July 24, 2001 ..... 1, 5, 6

Northern Sec. Co. v. United States, 193 U.S. 197 (1904) 9, 12

Parker v. Brown, 317 U.S. 341 (1943) 9

Premium Tobacco Stores, Inc. v. Fisher, 51 F. Supp. 2d 1099 (D. Colo. 1999) 4

PTI, Inc. v. Philip Morris, Inc., 100 F. Supp. 2d 1179 (C.D. Cal. 2000) 4

Cited Authorities

	Page
Rice v. Norman Williams Co., 458 U.S. 654 (1982)	9, 12
Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951)	9, 12
South Central Bell Telephone Co. v. Alabama, 526 U.S. 160 (1999)	5, 12
Star Scientific Co. v. Earley, No. 3:00 CV 835 (E.D. Va. Mar. 26, 2001)	5
State of Dakota v. Kisanlal Bastiram Sarda, et al., S. Dak. Circuit Court, 6th Judicial Circuit, Civ. 011-218, filed 5/18/01	9
State of Idaho v. Kisanlal Bastiram Sarda, et al., Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104212D, filed 7/6/01	10
State of Idaho v. P.T. Bentoel Prima, et al., Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104456D, filed 7/16/01	10
State of Idaho v. P.T. Perusahaan Rokok Tjap Gudang Garam, et al., Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104499D, filed 7/17/0	10
Vance v. Bradley, 440 U.S. 93 (1979)	5, 12

Cited Authorities

	Page
United States Constitution:	
Article I § 8, cl.3	1
Statutes:	
15 U.S.C. § 1	1, 9
15 U.S.C. § 26	1
18 U.S.C. § 2342	7
26 U.S.C. § 5754	4
42 U.S.C. § 1983	1, 7
36 Maine R.S. § 4383 (2001)	7
Alaska Stat. 43.50.145 (2001)	7
§§ 999.10-999.13, to Title 11 of the California Code of Regulations	11
MSA § VIII	3
MSA § IX(d)(2)(B)	6
NPM § 4383 (2001)	7
7 A.A.R. 3164, July 27, 2001	9
Other Authority:	
2001 NYSB58287	8

INTEREST OF AMICI[1]

Each of the Amici imports cigarettes (hereafter sometimes referred to as "foreign cigarettes") made by

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1. All of the parties to this proceeding have consented to the submission of this amici brief and their consents have been lodged herewith. No person or entity other than the amici curiae, or its members, has made a monetary contribution to the preparation or submission of this brief. No counsel for a party has assisted in the drafting of this brief, other than Patterson, Belknap, Webb & Tyler LLP. They acted as co-counsel with O'Connor & Hannan, LLP in representing the Amici with the exception of Tobacco Holdings, Inc. in an action against NAAG and fifteen state attorneys general charging that the state statutes declaring as contraband cigarettes made by non-complying manufacturers, including those lawfully imported to this country, and suits filed in state courts preventing the importer of such foreign cigarettes from selling them constituted an unlawful implementation of the MSA output cartel in violation of § 1 of the Sherman Act, 15 U.S.C. § 1 and discriminatory interference with their constitutional rights to engage in interstate commerce in violation of the Commerce Clause, Article I § 8, cl.3 and seeking injunctive relief to restrain such acts under § 16 of the Clayton Act, 15 U.S.C. § 26, and 42 U.S.C. § 1983. The complaint, captioned *North American Trading Company, et al. v. NAAG, et al.*, Civ. Act. No. 01-1600 (PLF), was filed on July 24, 2001 in the District of Columbia. On September 17, 2001, the district court dismissed the action for the plaintiffs' lack of standing, lack of subject matter jurisdiction and lack of *in personam* jurisdiction of the various state attorneys general even though the MSA requires them to act through NAAG and even though the district court denied discovery as to the activities of the state attorneys general within the District of Columbia. This ruling was issued from the bench and a written transcript thereof was filed on October 15, 2001. It is as yet unavailable on LEXIS or Westlaw. A notice of appeal to the U.S. Court of Appeals for the District of Columbia was filed on October 12, 2001. This action and the opinion dismissing it will sometimes be referred to herein as the *NAAG* case.

foreign manufacturers that are not members of the Master Settlement Agreement ("MSA"), described at length in the petition for certiorari. These foreign manufacturers do not make escrow funds payments under the so-called Escrow Statutes, also described in the petition for certiorari. They and the Amici were not parties, nor participated in the litigation that resulted in the MSA. They and the Amici were not parties to, nor did they participate in the MSA. Nevertheless, for the right to sell cigarettes in interstate commerce throughout the various states, the amici must pay an import duty of about 30¢ a carton in addition to the federal excise taxes which they likewise pay upon the cigarettes clearing customs. The Amici and at least 50 other importers of foreign cigarettes will effectively be wiped out unless this Court grants the petition for certiorari and bars as illegal under federal laws, the enforcement of the MSA output cartel described in the petition and in the Opinion of the Third Circuit.

The interest of the Amici thus is in the preservation of this trade and business. Because most of these importers, including the Amici, sell low priced cigarettes, the ultimate losers of this effectual prohibition of the sale of these foreign cigarettes will be the millions of smokers, who though desiring an alternative to the high priced brands manufactured and sold by the Majors, the four Original Participating Manufacturers to the MSA, will be forced to pay the higher prices imposed by the Majors. It is therefore in the interest not only of the Amici and other importers, but the country as a whole to have this Court adjudicate the legality under the antitrust laws and the United States Constitution of the output cartel set up in the MSA and implemented by the Majors and the Settling States.

STATEMENT

As stated in the Opinion of the Third Circuit ("Opinion" hereinafter):

> Together, the Renegade Clause, the Qualifying [Escrow] Statutes and the Enforcement Fund allegedly create severe obstacles to market entry, or to increasing production and market share. This is not accidental. The Multistate Settlement Agreement explicitly proclaims its purpose to reduce the ability of non-signatory cigarette manufacturers to seize market share because of the competitive advantage accruing from not contributing to the settlement.

The Enforcement Fund referred to in the Opinion is the $50 million payment made by the Majors to be used by the National Association of Attorneys General ("NAAG") set up to enforce the Escrow Statutes. MSA § VIII. This brief sets forth the anticompetitive effects upon the amici and other importers of foreign cigarettes created by the implementation of the Escrow Statutes, primarily through the Enforcement Fund.

The Amici and the other importers of foreign cigarettes have mounted a challenge, albeit a small one, to the strangulation of competitive pricing in the cigarette market accomplished by the MSA output cartel. At the time the MSA was executed on November 20, 1998, the Majors had about a 98% share of the national cigarette market. According to the Maxwell Report, dated August 21, 2001, the standard market report for the cigarette industry, due in large part to competition from foreign cigarettes, the share of the Majors

dropped in the year 2000 to 94%. This drop in market share has prompted the Settling States, the partners of the Majors in the output cartel, to take vigorous action to curtail sales of foreign cigarettes. This has consisted primarily of enforcing mechanisms set up in the MSA to protect erosion of the market share of the Majors necessary for maintaining the supra-competitive prices generated by the output cartel.

As pointed out in the certiorari petition (p.10), all of the Settling States had to and did enact so-called Escrow Statutes in order to avoid imposition of a severe diminution in settlement payments. These escrow payments require *all* cigarette manufacturers who have not joined the MSA to make non-deductible payments into escrow accounts for all of the various Settling States equivalent to the settlement payments they would have made on an annual basis if they had joined the MSA.

A principal cause of the output cartels market share erosion springs from the inherent limitation in the Escrow Statutes which require only manufacturers of cigarettes to make escrow funds payments.[2] As a matter of basic constitutional law, the obligation to make these escrow fund payments could not be imposed upon purchasers of cigarettes made by non-participating

2. The Escrow Statutes also require importers of cigarettes made in this country but shipped abroad and not intended for resale in this country, *i.e.*, gray goods, to make escrow payments. The constitutionality of requiring these re-importers of gray goods to make escrow funds payments was upheld in *Premium Tobacco Stores, Inc. v. Fisher*, 51 F. Supp. 2d 1099 (D. Colo. 1999); *PTI, Inc. v. Philip Morris, Inc.*, 100 F. Supp. 2d 1179 (C.D. Cal. 2000). These importers, however, were still free to import these cigarettes into the four Non-Settling States: Florida, Texas, Maine and Mississippi. The Majors thereafter prevailed upon Congress to enact legislation banning the importation of gray goods into this country. 26 U.S.C. § 5754.

manufacturers ("NPMs") who intended to resell them in the United States. That would have constituted preferential treatment of cigarettes offered for sale by members of the MSA and would have converted these obligations into a discriminatory excise tax because it effectively would have imposed an excise tax on all cigarettes bought from manufacturers not belonging to the MSA output cartel, and not making escrow fund payments and shipped into the Settling States. As such, it would have been invalid *per se*, under both the Equal Protection Clause[3] and under the Commerce Clause.[4] Because the Model Statute was carefully structured so as to avoid its being a discriminatory excise tax, its constitutionality was upheld in *Star Scientific Co. v. Earley*, No. 3:00 CV 835 (E.D. Va. Mar. 26, 2001).[5]

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3. *Vance v. Bradley*, 440 U.S. 93, 97 (1979); *Exxon Corp. v. Eagerton*, 462 U.S. 176, 195-96 (1983); *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 882 (1985). To avoid this equal protection problem, the Model Statute was drafted the way it was, *i.e.*, not to structure the payments as *de jure* taxes but rather refundable deposits.

4. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *South Central Bell Telephone Co. v. Alabama*, 526 U.S. 160, 169-170 (1999); *Fulton Corp. v. Faulkner*, 516 U.S. 325, 334-335 (1996).

5. The *Star* case is now on appeal to the Fourth Circuit, Appeal No. 01-1502. It is noteworthy for purposes of this case, however, that the *Star* decision was rendered prior to *Bedell*. The antitrust infirmities inherent in the Escrow Statute found by Bedell were never even raised by Star before the district court. Moreover, the issue of whether the Escrow Statutes *per se* constitute a direct interference with interstate commerce was not directly involved because Star itself was domiciled in Virginia and had its principal place of business there. The Amici, the plaintiffs in the *NAAG* case, did not attack the Escrow Statutes in that action but solely the unauthorized and illegal attempts by *NAAG* and the various state attorneys general to expand the reach of those Escrow Statutes to ban any sales in interstate commerce of cigarettes made by non-complying NPM's.

The MSA requires the Settling States to enforce "diligently" these Escrow Statutes. Failure to do so results in their receiving substantially less than their fully allotted share of the supra-competitive revenues generated by the output cartel. Lack of "diligent" enforcement subjects them to the so-called "NPM Adjustment" inserted in the MSA to recompense the Majors for loss of market share. MSA § IX(d)(2)(B). The failure to use "diligent" efforts to enforce the Escrow Statutes was described in a speech by Peter J. Levin, Esq., Economic Counsel for the Tobacco Project of the *NAAG*, the private association endowed with the $50 million fund by the Majors for coordinating efforts to enforce these Escrow Statutes. Mr. Levin described the following scenario in the speech given to the American Wholesale Marketers Association in which he urged these distributors, the major purchasers of cigarettes not to deal with NPMs or importers of foreign cigarettes:[6]

> So the states are going to do whatever they can to make sure that these statutes are enforced. They are very serious about it and there is a lot of money riding on it. And if there is one point that I want to make is that the states are very, very serious about this. We had an earlier seminar on statutory enforcement and one of the first power point slides that went up was a fake headline that said that State X loses hundreds of million dollars because it didn't diligently enforce its NPM Statute and that the governor was threatening to put the AG in jail and that the AG was threatening to put the NAAG people in jail.

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6. This speech is annexed as Exhibit 7 to the Dobbins Supplemental Aff., dated August 8, 2001 in the *NAAG* case.

Under this prodding, the Settling States have now proceeded to enforce "diligently" the Escrow Statutes by resorting to a number of strategies which appears to be facially unconstitutional under the Commerce Clause and thus violative of the civil rights of the Amici as well as all other importers of foreign cigarettes, and in fact all sellers in interstate commerce of cigarettes purchased from NPMs who have not made escrow fund payments, under 42 U.S.C. § 1983, *Dennis v. Higging*, 498 U.S. 439, 446, 451 (1991).

The most direct and effective way of wiping out the business of importers of foreign cigarettes is to convert the obligations to make the imposed escrow fund payments into what amounts to an excise stamp tax, mimicking the excise tax imposed by states on sales of all cigarettes but directed solely to cigarettes not made by MSA members and NPMs not making escrow payments. These states are now proceeding to do just that.

Maine and Alaska have just this past summer enacted statutes that classify cigarettes made by non-complying NPMs as contraband. 36 Maine R.S. § 4383 (2001); Alaska Stat. 43.50.145 (2001). The Maine statute subjects any wholesaler with a Maine tax stamp license to criminal excise tax punishments if it places Maine tax stamps on any cigarettes made by such an NPM § 4383 (2001). Alaska's law, effective July 3, 2001, does the same thing. It classifies as "contraband" any cigarettes made by a non-complying NPM, *i.e.*, the statute treats these in the same way as cigarettes on which a wholesaler has not placed the required excise stamp tax, and renders them subject to confiscation.[7]

7. The term "contraband" as used in connection with sales of cigarettes is a term of art, meaning packs of cigarettes on which the required state excise stamps have not been placed. 18 U.S.C. § 2342.

New York has also followed suit. It has enacted a law amending its tax law (2001 NYSB58287) which requires that all manufacturers of cigarettes sold in New York certify annually that the manufacturer is a participating manufacturer in the MSA or, if not, has made payments under the statutory schedule into the Master Escrow fund. Such certification must be delivered to the state official in order to have the appropriate cigarette stamps affixed to the cigarette package and if the certificate is not delivered or is false, any cigarette stamps affixed can be cancelled and a civil penalty of $5,000 imposed in addition to any other civil penalty.

By creating these trade barriers, Maine, Alaska and New York are apparently trying to make this cartelization of the nationwide cigarette market 100% watertight, at least in their respective jurisdictions. To do so, they necessarily have had to interfere directly with interstate and foreign commerce. If their efforts are judicially validated, it is highly probable that most of the other 43 states having these Escrow Statutes will follow their example. This high probability is apparent from the fact that *all* of the Settling States enacted Escrow Statutes to avoid having their annual settlement payments "docked", and unless they enact these contraband statutes they also risk having their annual settlement payments "docked" for lack of "diligent" enforcement.

These contraband statutes, invalid *per se* under both the Equal Protection Clause and under the dormant Commerce Clause,[8] are the final steps taken to implement the MSA output cartel.[9] They are directed at controlling all of interstate

8. See cases cited at n.3 and n.4, *supra*.

9. Arizona has even proposed a rule requiring detailed reports to be filed respecting, *inter alia*, cigarette sales by NPMs detailing (Cont'd)

commerce in cigarettes and discriminating against any cigarettes made by non-MSA cartel members that are non-complying NPMs. They are not immunized under *Parker v. Brown*, 317 U.S. 341 (1943) because they directly conflict with the prohibition in § 1 of the Serman Act, 15 U.S.C. § 1 against interstate cartels. All that the state action immunity doctrine enunciated in *Parker v. Brown*, sought to protect and all that it can protect without conflicting with the Supremacy Clause and Commerce Clause is essentially local intrastate commerce. It does not immunize actions undertaken to implement and make 100% watertight a nationwide output cartel.[10]

An alternative approach taken by the Settling States to outlaw the sales in interstate commerce of cigarettes made by non-complying NPMs is to bring actions in local state courts against any purchaser of those cigarettes that attempts to resell them in the particular Settling State. Such actions have already been instituted in South Dakota and Idaho.[11]

(Cont'd)
its sales of cigarettes in Arizona on which excise taxes are paid; the amounts of cigarettes "exported" from Arizona on which no excise taxes are paid; the failure to file such reports may result in the loss of licenses (7 A.A.R. 3164, July 27, 2001). Presumably, the next step, if the rule is adopted, is then to impose a "tax" for the benefit of the cartel upon all such cigarettes, with the penalty of not allowing sales of such cigarettes in Arizona if the tax is not paid.

10. *Northern Sec. Co. v. United States*, 193 U.S. 197, 346 (1904); *Rice v. Norman Williams Co.*, 458 U.S. 654 (1982); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

11. *State of Dakota v. Kisanlal Bastiram Sarda, et al.*, S. Dak. Circuit Court, 6th Judicial Circuit, Civ. 011-218, filed 5/18/01; (Cont'd)

These actions do not seek money damages against these sellers of cigarettes made by non-complying NPMs but rather seek solely to enjoin them from continuing to ship them into and sell them to customers located within South Dakota and Idaho. There is, of course, no basis under any principles of agency for bringing such actions in good faith. The Model Statute, Exhibit T to the MSA, which has been adopted by all of the Settling States, narrowly defines the firm obligated to make escrow payments as one which makes cigarettes.

The following hypothetical illustrates the *per se* discriminatory effects of these statutes and injunctions under the Commerce Clause: suppose that a manufacturer of dishwashers, *e.g.*, Whirlpool, has tax obligations to a particular state by reason of a franchise tax, corporate income tax, sales tax or any other state tax liability. Whirlpool sells its washers to Wholesaler X, located in another state, which in turn resells them to a retailer located the state in which the liability is owed. A statute or injunction forbidding the sale of dishwashers by third parties of any dishwashers made by a manufacturer that had not paid the tax liability, would be invalid *per se* under the Commerce Clause. The dishwasher, once sold by Whirlpool in interstate and foreign commerce, is entitled to be shipped freely by those purchasers in interstate commerce without a barrier being erected by a state based upon grievances which that state may have against the manufacturer of the article.

(Cont'd)

State of Idaho v. Kisanlal Bastiram Sarda, et al., Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104212D, filed 7/6/01; *State of Idaho v. P.T. Bentoel Prima, et al.*, Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104456D, filed 7/16/01; *State of Idaho v. P.T. Perusahaan Rokok Tjap Gudang Garam, et al.*, Idaho District Court of the Fourth Judicial District, County of Ada, Civ. OC-0104499D, filed 7/17/01.

What the contraband statutes and injunctions do is to convert the personal liability of the non-complying NPMs to make escrow fund payments into discriminatory excise tax obligations running with the product and, therefore, binding upon wholesales and retailers buying those products made by these manufacturers.

A different route to obtain the same result — a trade barrier against the shipment and sale of cigarettes made by non-complying NPMs — is not to seek legislative or judicial authorization for such interference, but rather simply to make a *de facto* expansion of the Escrow Statute without any enabling provision for any such regulation. Thus, the California Attorney General has proposed a regulation that effectively prohibits the sale by anyone of foreign-made cigarettes in California unless the manufacturer either belongs to the MSA or contributes to Californias escrow fund. The proposed regulation (§§ 999.10-999.13, to Title 11 of the California Code of Regulations, Chapter 11, entitled **"Confirmation of Compliance With [Escrow] Reserve Fund Requirements"**) requires that any wholesaler or distributor prior to selling cigarettes in California must receive written confirmation from a manufacturer that it has either become a participating manufacturer under the MSA or has made appropriate escrow payments. (§ 999.10) With respect to a purchase by a wholesaler from an NPM, written confirmation must be accomplished by the wholesalers obtaining a copy of the Certificate of Compliance filed by that NPM with the Attorney General that the NPM has fully satisfied its obligations under the Escrow Statute. (§ 999.11)[12]

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12. The California Attorney General held a public hearing on this proposed regulation on August 8, 2001, as a predicate to adopting it.

The Opinion has indicated that the actions taken by the Settling States in entering and carrying out the nationwide MSA output cartel are not immunized under the state action immunity doctrine for failure to meet the active supervision prong of *California Retail Liquor Dealers Assn v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). It is also clear under established authority that the output cartel is illegal, *per se*. Therefore, all of the foregoing regulatory activity, either by statute, injunctions or executive fiat, done solely and explicitly to implement this cartel, directly contravene the prohibitions of the Sherman Act and violate the Commerce Clause and the Equal Protection Clause of the United States Constitution, as well.[13]

It is a virtual certainty that the remaining 43 Settling States, as well as the District of \Columbia and the territories which have joined the MSA will seek to enact "contraband" statutes similar to those passed by Maine, Alaska and New York. To use Mr. Levin's terms, the States are "very very serious" about enforcing the Escrow Statutes. The failure to enact contraband statutes will empower the Majors to assert that they are not "diligently" enforcing the Escrow Statutes. Alternatively, and perhaps complementing these efforts to enact such contraband statutes, the attorneys general for the Settling States will bring suits seeking to enjoin the importers from selling cigarettes made by non-complying NPMs. Obviously, as a practical economic matter, it is impossible for the Amici, as well as all other importers — small businesses, to defend a multitude of suits throughout the various Settling States.

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13. *See* cases cited in nn.3, 4 and 10, *supra*.

Unless this Court grants certiorari to review the validity of the Opinion below, it is the foregone conclusion that the importers will be in fact annihilated. This may be, as the state attorneys general and NAAG argued in the district court in the NAAG action just referred to, a good thing and constitutionally permissible. The only way that can be definitively decided is for this Court to grant the petition for certiorari to determine definitively these questions. Otherwise, the enactment of the foregoing contraband statutes, institution of multiple injunction actions and passage of regulations, such as those proposed by the California Attorney General with resultant disastrous effects on the petitioners, will inevitably occur.

CONCLUSION

The Amici submit that the questions raised by this petition are of national importance and should be decided by this Court.

Respectfully submitted,

IRVING BIZAR
BALLON STOLL BADER & NADLER, P.C.
Attorneys for Amici Curiae
1450 Broadway
14th Floor
New York, NY 10018-2268
(212) 575-7900